



## Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact [support@jstor.org](mailto:support@jstor.org).

# THE PLACE OF THE INCOME TAX IN THE REFORM OF STATE TAXATION

T. S. ADAMS

The present paper is addressed to the economists of this Association in their professional capacity; it should be interpreted not as a defense of the state income tax, but as a plea for the reconsideration of a question upon which, apparently, the guild of economists is about to pronounce a final decision. Three quarters of a century ago the economists of the English-speaking world drifted into a position of antagonism to the trade union.<sup>1</sup> The consequences were unfortunate to everybody concerned. Today the economists of this country have lined up in opposition to the state income tax in an array so nearly unanimous that the outside world would be justified in asserting that current American political economy is against the state income tax.<sup>2</sup> Before such a decision is irrevocably registered and accepted by the economists themselves, I ask a rehearing. The reasons for this request are as follows:

## I

*The strongest arguments against the state income tax are not altogether convincing.*

1. The first of these is the assumption that the only kind of an income tax which can succeed in the United States is one constructed on the English model and dependent for its success upon the device of collection at the source. This assumption loses sight of the fact that a large majority of the successful income taxes now in force in Europe make practically no use of

<sup>1</sup>This has been denied, but the more authoritative opinion seems to support the statement in the text.

<sup>2</sup>Mr. Lawson Purdy, an authority for whom the writer has the greatest respect, goes out of his way in a paper on the federal corporation income tax, to express this opinion: "It has been suggested that the power to tax incomes should be reserved to the states. This suggestion must be made in derision, or in profound ignorance. Several states have tried to impose income taxes and failed utterly, as they must fail. The only income tax which has a chance of success must be patterned after the British income tax, which taxes all incomes and uses corporations as tax collectors. This requires nation-wide jurisdiction." *State and Local Taxation*, Third International Conference under the auspices of the International Tax Association, p. 229.

the device of collection at the source—or no more use of the device than any American commonwealth could easily make. In fact, of the large number of state income taxes collected on the continent of Europe, only those of Spain, Italy, and Norway, so far as I can learn, make extensive use of collection at the source. It is very difficult to get information concerning the efficiency of these lump-sum income taxes. Some of them are doubtless failures from the administrative standpoint, as in the Swiss canton of Zurich. But a few of them are conspicuously successful, and many of them, from all that can be learned, are quite as successful as our American tax on real estate.

2. Continental experience with the income tax furnishes sufficient reason to doubt another of the arguments confidently adduced against the state income tax, the argument that the income measure or basis is particularly unsuitable for local taxation, and that the chances of success of the income tax increase *pari passu* with the extent of territory over which it is levied. Saxony (with only 4,202,216 inhabitants in 1900) collects a progressive income tax and, from all that can be learned, administers the tax successfully, as does Baden (with less than 2,000,000 inhabitants in 1900), Bavaria (with a population of 6,176,057 in 1900), and many of the other German states which are even smaller. In several of these commonwealths, moreover, income is employed as the basis of both state and municipal taxation. In Prussia, for instance, according to the latest statistics which I have seen, the municipalities collect 54 per cent more on the basis of income than the central government itself. And yet American writers constantly assume that if the federal government is to employ the income tax, the several state governments must forego that privilege. In point of theory there is no tax so suitable for use by both federal and state governments as the income tax, and if the rates are kept moderate it is hard to see any practicable objection against this dual system. Of course, if we must collect at the source, a federal income tax is the only form which has any chance of success. But, as European experience suggests, collection at the source is not indispensable.

3. Closely connected with the preceding argument is the contention that state income taxes in this country, if widely introduced, would give rise to an intolerable amount of double taxation. They might, but they need not necessarily do so. Income taxes are of two varieties, business and personal income

taxes. The business income tax is a tribute which business may properly be called upon to pay for the protection afforded by the state and the opportunities provided to exploit the commercial opportunities of a given district. Business income taxes accordingly should be paid at the source, where the income arises, and should go to the tax jurisdiction in which the income arises—not the jurisdiction in which the recipient of the income resides. Personal income taxes, on the other hand, are paid for the benefits which the individual receives from the state as a consumer, for the streets on which he walks, the parks in which he takes his recreation, the schools which his children enjoy, the personal protection which he and his family receive from the police, the health commissioner, and other officials. Personal income taxes should be adjusted to the entire ability of the taxpayer, and should be paid to the jurisdiction in which he resides. A state legislature levying a business income tax may properly tax every dollar of income arising in the state, whatever its ultimate destination. The state legislature levying a personal income tax may legitimately tax a resident on all his income, whatever its source. The legislature in question may levy the business tax alone, in which case it should keep its hands off mere residents and abstain from taxing income arising outside the state; or it may levy the personal income tax alone, in which case it should keep its hands off mere business and abandon all taxes on income arising in the state but accruing to non-residents; or it may levy both kinds of taxes, in which case it may tax both species of income without injustice and without inconsistency. Either principle or both principles may be applied and no difficulty will result so long as the application is consistent and thorough. Evil results when the legislature tries to juggle the two principles to its own advantage, taxing only once those citizens who both reside in the state and earn all their income there, but endeavoring in addition to tax those non-residents who draw an income from the jurisdiction in question.

Fortunately for my contention at this point, but unfortunately for the practice of taxation, the difficulty now under discussion applies to the general property tax, the inheritance tax, and many other forms of direct taxation. The introduction of a state income tax would make the situation neither better nor worse. There is much double taxation of an inequitable kind at present. It arises from legislative greed and confusion concern-

ing the difference between real and personal taxation. It can be remedied in two ways: (a) by a constitutional amendment empowering the federal government to control the assessment of direct taxes by the states; or (b) by a process of education which will lift state legislatures above the greed and confusion which are responsible for the present situation. I do not believe that we shall ever get the constitutional amendment, and I do believe that on this point our legislatures can be educated. In point of fact, it is probable that the income tax, because of the earnest discussion that would almost necessarily attend its introduction, would materially assist in the helpful educational process on this subject which is now going on. In any event, it is hard to see how the reproach of double taxation can be consistently urged against state income taxation, when we remember that such a tax is proposed as a substitute for the present tax on personal property and it is the tax or taxes on personal property which are responsible for most of the double taxation that now exists.

4. Much the same attitude, it would seem, must be taken toward the criticism voiced by high authority that state taxation of incomes would lead to the migration of capital and impel the wealthy citizens of states employing such taxes to take up their residences elsewhere. European experience in the smaller continental states does not justify such apprehension. One occasionally finds in the literature on the subject some casual reference to such danger, but the general absence of this reproach in European discussion warrants the inference that it is not a real defect of the lump-sum income tax common on the Continent.

I am perfectly willing to confess here, as in other aspects of this subject, that European experience is not conclusive. But it is difficult to see any logical ground for the fear that income taxation would cause a migration of the millionaires. A state income tax, if introduced, would take the place of existing taxes on personal property. The amounts raised by the income tax would be subtracted from the general property tax, thus lowering its rates. I can see no reason why desirable citizens should withdraw under such circumstances and seek a new environment in which the general tax burden would be just as heavy and where in addition they would be pestered with the personal property tax, a form of taxation which is always disagreeable and which not infrequently forces the taxpayer to resort to what, in a strict construction of the law, must be regarded as perjury.

5. As stated above, it must be confessed that the success of the lump-sum income tax on the continent of Europe does not prove that such taxation could be made to work in this country. But for similar reasons it must be insisted that American experience with the state income tax furnishes no conclusive argument against its practicability. In his valuable work entitled "Income Taxation", Mr. K. K. Kennan concludes a discussion of the Massachusetts income tax in these words: "On the whole it must be conceded that the experiences of the State of Massachusetts in attempting to tax incomes, in spite of the fact that those experiences extend over so long a period, are of such a character that they form no proper basis for an argument either for or against state taxation of incomes."<sup>3</sup> That verdict, in my opinion, must be passed upon the general experience with state income taxes in this country. The laws themselves are in many instances absurd on their face; in other states the heart is taken from the whole project by exempting from income taxation all income arising from property taxed under the property taxes, thus leaving practically nothing for the income tax to reach; in still other states a fairly reasonable law has been left to enforce itself and no real effort has been made to meet the administrative problems involved; while these states in which some little effort at enforcement really has been made are primarily agricultural states, in which, as I shall show hereafter, income taxation is least needed and most difficult of enforcement. We have merely played at state income taxation in this country; we have never given it a fair trial.

Many students will conclude from this that we are administratively incapable of giving it a fair trial, and there is much to be said for this view. It is probably not true, however, for all parts of this country. As a people we are going to do some things in the near future which we have unsuccessfully tried to do for generations. We are going to suppress lynching in my opinion; we are going to reform—substantially if not perfectly—the antiquated tax on personal property; and it is not at all impossible that in some places the removal of the personal property tax will be followed by a fairly successful local income tax. The scholars of this country may be economic determinists, but the people are not.

---

<sup>3</sup> K. K. Kennan, *Income Taxation*, p. 222.

6. Success in taxation, of course, demands as a condition precedent good administration. But, it will be urged, if you have good administration you can enforce almost any tax, even the general property tax. This criticism is in my opinion unsound. There are some fiscal tasks beyond the powers of any American administrative machine, however good, which we have any legitimate reason to hope for in the next fifty years. One of these tasks is the detection and accurate appraisal of all forms of personal property. The property tax does not lend itself to lump-sum assessment. Its logic requires that property shall be listed and separately appraised. The tax is on the thing. The income tax does lend itself to lump-sum appraisal. Finally, income may be approximated much more successfully from external indicia than property. The dwelling of an individual and his general mode of life tell a great deal about his income. They tell almost nothing about the property to which he possesses the title, and which may in the greater part be covered by indebtedness for which the tax law entitles him to no exemption. A reasonably complete enumeration and appraisal of personal property at the residence of its owner seem to me impossible; but a reasonably complete enumeration and appraisal of incomes to their recipients, appeals to me as distinctly practicable.

## II

*A state income tax properly devised compares favorably with any of the proposed substitutes for the tax on personal property.*

1. The first alternative plan of reform which must be considered is the attractively simple scheme of abolishing the tax on personal property, leaving the necessary revenue to be raised by a single tax on real estate, or upon real estate plus a few simple forms of tangible personalty. It is impossible here and now to give to the single tax as thorough a discussion as it deserves, and it will be necessary to state rather categorically the reasons why in my opinion it does not offer a practicable method of reforming the general property tax.

(a) The first of these reasons is the unwearied persistence of the people in their demand for some form of personal taxation. Nowhere in the world over a large territory within my knowledge is there any sign of the abandonment of the principle that men owe a personal fiscal allegiance to the state and that they ought

to pay some taxes in the district in which they live, whether they possess any property in that district or not. In New York City, perhaps, and a few similar places, personal taxation may be abandoned in the next fifty years, but in such event there will still be room for the income tax in the taxation of business.

(b) In the minds of a majority of the people in most communities land is too heavily taxed at the present time; and I agree with popular opinion in the belief that to a certain extent the taxation of real estate increases rent and real estate values. I realize that good economic theory justifies the conclusion that a tax on land is not shifted, but this applies only to "land" as that word is used in economic theory, that is, to those elements of real estate that are durable and not capable of multiplication. Accordingly, the theory of the single tax does not apply to buildings, nor to any part of the value of urban real estate which is created by the investment of capital or labor, nor to the fertility of agricultural land which is neither durable nor incapable of reproduction.

(c) To the extent that the value of land is reduced by special taxation it involves an expropriation of the present owners. If the tax promises to increase, it involves a further degree of expropriation. Such expropriation may be just or unjust; it is not necessary to decide that question here. The important point for us at the present time is that no such measure of expropriation has a chance of acceptance by the people of this country in the near future. Fortunately or unfortunately, the abolition of all taxation upon property other than real estate at the present time in this country is not a practicable project of reform.

2. The second substitute for the taxation of personal property presents a twofold aspect. It proposes the habitation tax in lieu of the present taxation of household goods and purely personal property, and the rental tax or the graded license tax in lieu of taxes on the machinery and stock, credits and other personal property of manufacturers, merchants, and other business men. The fundamental idea underlying these taxes is the same. The ideal is to adjust the tax burden to income, but to measure income by certain external indicia which are supposed to simplify indefinitely the work and responsibility of both the assessor and the taxpayer.

(a) The Habitation Tax. The weakness of the habitation tax lies on the surface. The richest man in a city in which I



once lived, for instance, resided in a single room in a cheap hotel. To have used the rental value of his habitation as a measure of his ability or *taxability* (to coin a convenient word) would have been obviously absurd. Of course this extreme illustration is not wholly fair to the real virtues of the habitation tax. But the illustration does arouse a train of thought which is valuable in this connection. Why rest content with rental value as an evidence of income when we know it is misleading? Why not use the habitation tax as a minimum to be indefinitely improved by any additional evidence which the assessor can secure? In short, why not have an income tax which is operative as a habitation tax when the assessor is doubtful of the returns of the individual taxpayer?

I believe that the future will see in American state taxation an ever increasing use of external indicia. But attention should be called to the fact that these external evidences can be far more successfully employed by administrators than by legislators. The relation between income and rental is at best a relation between types, and holds not for individuals but for averages. Moreover, the relation changes with the time, the place, and the circumstances of the taxpayer. An instrument so delicate and variable is not likely to be wisely handled by a busy state legislature. If enacted into statute law, it must be stated so simply and rigidly that it will work a vast amount of unnecessary injustice. If, however, it could be applied by a first class tax commission capable of investigating the different relations between income and the external index at different times and different places, it would be capable of an indefinite amount of good. My proposal, in other words, is to place the administration of the income tax in the hands of a central tax commission, and authorize that commission to devise and apply all helpful kinds of external indicia in the assessment of incomes when the commission has reason to believe the return of the income has not been honestly made. Some such procedure as this is what we are now as a people attempting in the introduction of rate regulation. That is to say, we are organizing expert central commissions and charging them with the duty of enforcing "just and reasonable rates." We know that the ideal is impossible of complete realization, but we confidently expect an approximate realization of the ideal. A central tax commission could, in matters of taxation, attack this problem of taxation with as much chance of success as our

public service commissions are attacking the intrinsically far more difficult problems of rate regulation. Such a commission can safely be vested with an administrative discretion in the use of external indicia, which could not be entrusted to ordinary local assessors. Moreover, business men would be far more willing to make disclosures to the agents of such a central commission than to local assessors under no central control.

(b) Business Taxes. Very similar arguments can be cited against the taxes most frequently proposed as substitutes for that part of the general property tax which is applicable to business concerns.

A flat license tax with little or no adjustment to profits is or may be highly productive, certain, and inexpensive to collect. But it is so regressive that it stands practically no chance of adoption in states north of the Mason and Dixon line.

The moment we depart from flat rates, however, we get into trouble. Immediately there begins a differentiation or classification in accordance with character of business, size of town in which the business is located, gross profits, and other indications of *taxability*, which has no logical stopping place short of an income tax. And the process of evolution is not a seductive one. First there comes the logrolling in the legislature and pressure from various commercial interests to obtain a favorable status in the law itself. After the law is passed, the assessor has a continual struggle with the taxpayer to get him properly classified. Some experience in Porto Rico with a graded license tax modeled closely on the French *impôt des patentes* led me to the conclusion that the proper classification of business concerns in the assessment of a finely graded license tax is as difficult as, or more difficult than, their proper assessment under an income tax. And the experience of Louisiana with the graded license tax is apparently similar to that of Porto Rico, as the Louisiana Tax Commission of 1906 (reporting in 1908) after going on record "as opposed to the principle of license or occupation taxes on ordinary pursuits as a permanent source of revenue", went on to say regarding the operation of the tax: "In addition to this there is no form of tax which provokes such a flood of perjury as accompanies the levy and collection of these taxes. The amount of the tax depends on the return of the taxpayer. The honest taxpayer makes an honest return. The dishonest taxpayer makes a dishonest return. Large numbers of persons make their affidavits with the

same looseness of morals with which the average respectable citizen will attempt to defeat the customs laws on returning from a trip abroad. They regard cheating the government as venial, and not in the category of crimes."

In Canada business concerns are quite generally taxed in accordance with the rental value of the premises which they occupy or the floor surface of such premises. In some of the provinces these methods of taxation have been consciously introduced as substitutes for preëxisting taxes on personal property. In the case of the Canadian taxes just described, as in the case of most other foreign taxes, it is difficult for the outsider to ascertain with any certainty just how successfully they work. It may be said with certainty, however, that these taxes are far superior to the American method of taxing the personal property of business enterprises. But from all I can learn, they are not without serious defects. They create exceedingly difficult questions of classification, because the rental value or the floor space bears an entirely different relation to net income among the different classes of business enterprises, and the rates have to be adjusted accordingly. In consequence the legislative body which imposes such taxation is constantly beset with applications for changes in the classification, while at the same time a certain amount of plain injustice always exists because of the impossibility of adjusting any simple classification to the varying ability of business concerns.

Here, again, it may be asked, why take the half loaf when we can get three quarters or four fifths? Why not develop these external indicia by scientific study and use them administratively as an aid in the assessment work, rather than enact an unduly simple and regressive scale into statute law? Of course, all this assumes much better assessors than we now have; but, unless we get better assessors, any scheme of reform is doomed. As will be seen hereafter, I am counting upon administrative reform as the principal recommendation of the income tax. I would much rather have a reform of the assessment work without the income tax, than the income tax without reform of the machinery of assessment.

3. The next reform which calls for careful consideration is what Professor Bullock has aptly called the "graded property tax." The essential proposal here is to reduce rates upon each class of property until the natural inclination to be honest

balances and then overcomes the temptation to evade the tax. This plan of reducing rates has been tried with very successful results, so far as the yield of the tax is concerned, in Pennsylvania and Baltimore.

All students of American taxation must feel deeply grateful to the champions of this reform in Pennsylvania and Maryland. It has taught us the exceedingly important lesson that a tax which is exorbitant can not succeed in an American commonwealth unless the property upon which it falls is tangible and irremovable. It has taught us, also, that there are large numbers of American taxpayers who will be honest if the state gives them half a chance. But its principal lesson may be summed up in the axiom that tax rates, like railway rates, must be fair and reasonable if the tax is to succeed. So deeply do I feel that this lesson should be taken to heart that I do not hesitate to say that the success of the income tax or any other reform project is wholly dependent upon its thoroughgoing adherence to this rule that tax rates must be fair and reasonable. Observance of this rule, in my opinion, is the principal explanation of the success of the lump-sum income tax in certain states on the continent of Europe.

But the graded property tax has, I fear, certain difficulties which would make it unpopular with the American people, and which to my mind make it inferior to the income tax. The difficulty lies in the fact that it provides no means of reaching the dishonest taxpayer, who will evade small reasonable taxes as well as high and unreasonable taxes. Notwithstanding the very large amounts of intangible personalty on the tax rolls of Pennsylvania and the city of Baltimore, it is probably true that many owners of intangible personalty in these places successfully evade taxation. The graded property tax, therefore, will relieve the treasury, but it will not remove the unfair burden upon the honest taxpayer. As a matter of fact, it actually increases the burden upon those taxpayers who are inclined to be reasonably honest. The form of income tax which I have recommended, however, would permit the taxation of those persons who are not disposed to make an honest declaration of income on the basis of any external indicia which the central assessment commission finds helpful in this connection. In other words, the income tax is easier to assess than that part of the property tax which falls upon intangible personalty.

4. In concluding this brief survey of the popular substitutes for the personal property tax, I am glad to confess that any one of them is greatly preferable to the personal property tax. But the income tax offers a more practicable substitute. My reasons for this conclusion have only been stated in part. These further considerations may be added:

(a) Most important of all is the fact that the income tax is popular. The people are familiar with it. There are things about it which thoughtful people do not like. But its spirit strikes a responsive note in the mind of almost everyone. The people, on the other hand, know practically nothing about the substitutes which are discussed so familiarly here, and I fear none of them would stand any chance of adoption until after a long period of public education. Moreover, the income tax is the goal, the ultimate ideal of the habitation tax, the business rental tax, the graded license tax, and the graded property tax. Why not start as near the goal as possible?

(b) Next in importance is the fact that an income tax will force a better administrative system, whereas the substitutes of which I have spoken seem designed from some viewpoints to pamper and coddle the weakness and inefficiency of the assessor. They all seem to be based upon this sort of reasoning, that, whereas the average American assessor is incompetent, therefore let us change our tax laws to fit his incompetence. Any tax which makes impossible demands upon the assessment machinery is, of course, bound to fail. But it is very important that the reform which we advocate should demand as its most fundamental condition the introduction of reasonable efficiency in the work of assessment. Of course there is no necessary reason why administrative reform should not accompany the introduction of these other substitutes for the personal property tax, and the economists who champion them usually insist that they would help to bring about administrative reform. But the average legislature, I fear, will find in these alternatives merely an excuse to amend the tax laws without rehabilitating the assessment machinery. In the case of the income tax, however, such procedure would be plainly suicidal. In the existing state of economic knowledge on the subject, any legislature which introduces an income tax without providing for fundamental administrative reforms as a condition of its introduction would be guilty on the face of political hypocrisy.

## III

*The conditions to which a successful income tax must conform.*

I have already suggested in an anticipatory way the kind of income tax which might have a fair chance of success in a system of state taxation. It is necessary, however, to state these conditions more explicitly.

1. First of all, the income tax should not be applied to farming districts. Few farmers keep books; and few have any accurate notion of the money value of their incomes, because of the fact that their income consists in such large measure of the food which they themselves raise and of an intangible increase in the value of the land which they own. The average American legislature, moreover, is not likely to attempt to tax family incomes of less than \$1000 a year, and such an exemption limit would relieve a very large majority of farmers in most districts of the United States from taxation. The income tax, therefore, would degenerate into a mere instrument for increasing the share of state taxes borne by the urban districts; and, considering the excessive burdens thrust upon our cities by the mere growth of population, such a result would be doubly unfortunate. Moreover, real estate, farm animals, and farm machinery (all of which can be readily detected and easily assessed) cover so large a proportion of the wealth in farming districts that there seems to be no excuse for the introduction of an income tax, particularly when we remember that the assessment of such a tax would not only be unusually difficult but particularly expensive in the country. Finally, it should be added, certain investigations conducted under my direction into the relation between the net profits or income of farmers and the rental or capital value of their farms, indicate that this relation is exceedingly variable, so that an arbitrary measurement of income from capital or rental values, as is done in the English income tax, would work a large amount of injustice in this country.

2. It is obvious that the term state income tax as used in this paper is in one sense a misnomer. The tax should be confined to urban districts and its proceeds should be used for local purposes. It is a local rather than a state tax. Its assessment, however, should be under state control; the assessors should be appointed by a central tax commission, they should hold office during good behavior, and work under administrative regula-

tions laid down by the central commission. Whatever may be the value of home rule in general, it has little or no place, in my opinion, in the administration of tax laws. This is too large a question to be settled here,<sup>4</sup> but it may be asserted with confidence that the path of improvement lies in the direction of greater centralization, more control both by the federal and the state governments.

At the present time important classes of corporations are in most states assessed by central tax commissions. In order to facilitate the assessors' work, such corporations render to those commissions detailed reports of their income and business operations. No great trouble has been experienced in securing such reports and no abuse has arisen in connection with the system. If an income tax is to be introduced applying to business concerns, wider use should be made of this method of assessment. Business concerns should be required to report to such a central commission not only the profits of the concern as a business unit, but the salaries received by its more highly paid employees and the dividends paid to such of its stockholders as reside within the state. These data could be used in the assessment of the personal income tax. This method of assessment has worked with the corporations, because they respect the power of the central commission, and because they trust it. They are certain that their reports will be treated as confidential. This method, in my opinion, can be successfully enlarged and made to work in the taxation of business generally. But if it is to be enlarged, it is exceedingly important that its essential character be preserved; the large force of agents or assessors which will be necessary must not be locally elected, but remain under the control and discipline of the central commission.

3. A third condition which impresses me as necessary is a thorough understanding of the distinction between personal and business income taxes. That there is such a distinction has already been emphasized. The further fact that these taxes are noticeably different needs some explanation.

The personal income tax which a man pays at his place of residence ought so far as possible to be measured by his ability, as reflected in his net income from whatever source derived, either

---

<sup>4</sup>I have discussed it more fully in *State and Local Taxation*, First National Conference under the auspices of the National Tax Association, pp. 515-527.

within or without the jurisdiction in which he lives; and, according to the preponderance of testimony, ought if practicable to be progressive. In addition, cognizance should be taken of the size of his family, sickness, death, and other misfortunes which tend to reduce his *taxability*. The personal income tax measures the human obligation of a man as a member of the body politic.

The business income tax, on the contrary, expresses the obligation which a successful business owes to the district whose commercial opportunities it is permitted to exploit. The income to be taxed in this case is not net income, but net income plus interest payments on bonds, and other forms of indebtedness which from this point of view must be logically regarded as interests in the business. Under a business tax, income arising in the jurisdiction may be taxed there whether the owner lives outside the jurisdiction or not. The rate, moreover, as I understand it, should not be progressive, inasmuch as a large business with large profits may be owned by a very large number of small stockholders whose separate share of the profits may be very small indeed. There are some arguments for progressive rating even in the business tax, but they do not impress me as sound and they create almost insoluble practical difficulties.

The danger of confusing the personal and business income tax is great, because of the custom of collecting personal income taxes at the business source. Whether the personal income tax is collected from the business or not, the fact remains that the personal tax is substantially different from the business tax and must be differently treated. Unless this truth is recognized, the ordinary legislative body is almost sure to fall into the unjust and demoralizing error of attempting to tax those residents whose income arises in the jurisdiction only once, while at the same time it attempts to tax other residents on their income arising outside the jurisdiction, and non-residents on that part of their income which arises within the jurisdiction. If all income arising in the jurisdiction is taxed under a business tax and all residents are assessed under a personal tax on income arising from every source, then those residents whose entire income is secured within the jurisdiction must also be taxed twice. There is only one just and practical rule in this connection: to so act that other jurisdictions may pass the same kind of tax laws without doing injustice to the ever growing class of citizens who live and work in different places. The same problem exists in property taxation.



It will never be solved until we have the dual system of personal and business taxes working side by side, because the only alternative permitted is an interstate agreement, and that will probably never be secured.

4. Finally, there should be included among the prerequisites of a successful state income tax, low rates and the abolition of nearly all taxes upon personal property. Whatever be the requirements of ultimate justice in regard to progressive rating, any high degree of progressivity in the near future would probably prove fatal to the local income tax into which it was introduced. No income tax at the present time can violate the ethical standards of the great mass of persons who are called upon to pay the tax, and succeed. A progressive federal income tax might possibly be enforced against the will of the mass of people subject to it, but a state income tax could not.

#### IV

##### *Political considerations*

The reform of the general property tax is a problem of practical politics, and some brief reference to this aspect of the question is necessary. The one thought which there is time to consider is the fact—so I deem it—that if any reform of the general property tax worth while is to be achieved, it is necessary to appeal much more strongly than we have ever done to the deep and persistent feeling of the people for uniformity and equality and justice in taxation.

In spirit the general property tax represents an attempt to tax each man according to his ability as measured by his wealth in real and personal property. This attempt has failed—signally. American economists have been deeply impressed with this failure, so deeply impressed that they have not only agreed, substantially, in counseling the people to content themselves with certainty, simplicity, and administrative sanity in their tax laws; but they have appeared to lose sight for the moment of the persistent, century-old, unabated striving of the people for uniformity and equality in taxation. It is not impossible that the sentiments of the people here are sounder than the severely practical reasoning of the economists. I pass no judgment on that question and for the moment I am perfectly willing to laugh at this

sentiment with the cynics or enthuse over it with the sentimentalists. What I do maintain is this: first, that it is the part of wisdom to utilize this sentiment; and, second, that no substantial measure of reform will be achieved in many of our states until it is utilized.

To the first part of this thesis I anticipate no objection. Everyone will probably agree that it is expedient to utilize a popular feeling if it can be done by the proposal of laws that are both just and workable. There is surely no reason why the scientific student of politics should leave to the demagogue the advocacy of all those laws which have a chance of passage and without necessity confine himself to that which is unpopular and bizarre.

That it is necessary to utilize the popular feeling for uniformity and equality, needs some little discussion. The average taxpayer is a curious mixture of selfishness and altruism. First of all, perhaps, he is against anything that will increase the tax burden upon himself and his class. After that he is an earnest but rather superficial advocate of equality, uniformity, and justice.

Admitting for the sake of argument that the selfish feelings are the stronger feelings, it nevertheless seems demonstrable that no measure of reform worth while can be achieved by appealing to those feelings. Their net result is simply to maintain the *status quo*. Owing to the almost universal prevalence of under-assessment and evasion at the present time, every taxpayer is at once a victim and a beneficiary of lawbreaking, and reform is blocked because no man knows whether he gains more in the latter than he loses in the former capacity. Moreover, John Doe will do nothing to relieve the injustice under which Richard Roe is suffering, because John himself is smarting under some petty grievance of his own and because he knows of a score of other classes which are suffering greater injustice than that borne by Richard. Self interest merely ties our hands and we continue to welter in this slough of legislative indifference and administrative incompetence. We shall not arise from it until an appeal is made to our patriotism and our sense of justice, until we are brought to feel as a people that efficient democracy is the only kind of democracy worth while or permanently tenable. Consider what has been done with the coldly practical recommendations of our state tax commissions, sum up the practical results of the severely unsentimental plans of reform elaborated by our economists, be-

fore you decide that nowhere and under no circumstances can the income tax be of service in the reform of the general property tax.

The supreme desiderata in American taxation are the abolition of the tax on personal property and the improvement of the assessment work. These ends must doubtless be pursued differently in different parts of the United States. The method of attack suitable to New York City and the Atlantic seaboard is not likely to be the best method of attack in Wisconsin and the "insurgent" states of the Middle West. But in some of these states the ends which we seek are not unlikely to be accomplished through the instrumentality of the income tax. The tax is popular, the people want it, and to get it—if they are intelligently guided—they will sanction the administrative changes necessary to make it a success. It satisfies their ethical instincts and arouses their interest, when such projects as the single tax, the habitation tax, and the graded property tax leave them hostile or wholly indifferent.

American economists should not stand in the way of experiment with substitutes for the personal property tax, even the income tax. The present situation is so bad that we have everything to gain and nothing to lose by experimentation. According to an investigation made by the Wisconsin Tax Commission in a typical Wisconsin county, the intangible personalty of estates passing through the probate courts was assessed at only 3.31 per cent of its true value, and I see no reason to believe that intangible personalty is better assessed in the average American county. Surely the income tax could not result in such an utter failure.

In fact, it is probable that the assessment of incomes could be made even more satisfactorily than the assessment of real property at the present time. Few of the economists who hold real estate taxation up as the successful remnant of the American property tax realize how far from perfect the assessment of real estate now is. The Wisconsin Tax Commission conducts regular, systematic, and thorough investigations into the relation between the assessed and the true value of real estate in Wisconsin. From the data collected by the Commission, the following figures for a representative county, a representative but small city, and for nearly all the assessment districts of the state, indicate how irregular and uneven the assessment of real estate is in a state which is above rather than below the average in the character of its assessment work.

RATIO OF ASSESSED TO TRUE VALUE OF REAL ESTATE IN WISCONSIN  
BY CLASSIFIED GROUPS.<sup>5</sup>

Ratio of Assessed to True Value	Averages for entire assess- ment districts	A representa- tive county	A small city
	Number of assessment districts	Number of parcels of real estate	Number of parcels of real estate
Under 20. per cent.	2	—	—
20 to 29.9 " "	18	10	6
30 to 39.9 " "	97	34	20
40 to 49.9 " "	294	44	28
50 to 59.9 " "	393	49	74
60 to 69.9 " "	371	31	71
70 to 79.9 " "	201	11	40
80 to 89.9 " "	68	11	35
90 to 99.9 " "	23	7	13
100 per cent and over	7	7	17
Total.....	1474	204	304

As was stated in the beginning, this paper is not primarily a defense of the income tax, but a plea to the economists of this country to pause and think once more of the possibilities of the local income tax before declaring flatly that its introduction would be unwise. It is possible that some may agree with me that under the conditions laid down in this paper a local income tax might be made to work. To such persons in particular it may be predicted with confidence that within a comparatively short time these conditions will be possible of fulfillment in some parts of this country. In many sections the people are nearly ready to abandon the tax on intangible personalty provided a substitute can be found which satisfies their sense of justice. The income tax does this. In some of these sections central tax commissions are already in existence empowered to make the assessment on certain forms of business enterprises, to investigate and correct defective assessments locally made, to remove inefficient assessors, and, in at least one state, to appoint assessors from the beginning and rigidly supervise their work. Are we to say to such states that a local income tax would be a

<sup>5</sup> I am indebted to Mr. A. E. James, the Statistician of the Wisconsin Tax Commission, for these figures. The figures for the assessment districts are for the year 1905, those for the typical county for 1908, and for the small city for 1905 and 1906.

mistake and an absurdity? In the state of Wisconsin—which in its primary election law, its civil service requirements, its central tax commission, and its laws regulating railways and public utilities, has set a striking example of progressive legislation made sane and practicable—the people have by popular vote ratified a constitutional amendment permitting the introduction of an income tax and practically every party in the state has pledged itself to the introduction of such a tax. Here is a condition and not a hypothesis confronting us. What have the American economists to say to the people of Wisconsin?